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March 26, 1997

1997

BY HAND DELIVERY

Mr. William Caton
Office of the Secretary
Federal Communications Commission
1919 M Street, Room 222
Washington, D.C. 20554

Re: In the Matter of Implementation of Section 273 of the Communications Act of 1934, as amended by the Telecommunications Act of 1996

Dear Mr. Caton:

Please find enclosed for filing the original and eleven copies of SBC Communications Inc.'s Reply Comments in the above proceeding.

Enclosed please find an extra copy for date-stamp.

Sincerely,

Howard A. Shelanski

Howard A. Shelanski

Enclosures

No. of Copies rec'd 0+11
List ABCDE

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Implementation of Section 273 of the Communications Act of 1934, as amended by the Telecommunications Act of 1996	CC Docket No. 96-254

REPLY COMMENTS OF SBC COMMUNICATIONS INC.

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SUMMARY

In these Reply Comments, SBC Communications Inc., on behalf of itself and its subsidiaries, Southwestern Bell Technology Resources, Inc. and Southwestern Bell Telephone Company, responds to several Comments advocating regulations that would contradict the language of the 1996 Act and undermine Congress intent in enacting section 273. Specifically, SBC addresses the following points:

- As section 273(h) establishes, the AT&T Consent Decree's definition of "manufacturing" applies in section 273. The Commission should reject suggestions that the decree court's definition be expanded to include software that is not integral to hardware, such as network or applications software used to provide a telecommunications service, software with incidental equipment functions, or software used to develop operational support systems or service control points.

- Collaboration during design and development of hardware and software pursuant to section 273(b)(1) is not limited to generic specifications or to network interconnection and interoperation. Such a restriction would render section 273(b)(1) meaningless, for the provision would then permit only that which was already allowed prior to the 1996 Act. Section 273(b) expressly carves out from subsection (a) design and development activities that constituted forbidden "manufacturing" under the AT&T Consent Decree.

- Manufacturing activities pursuant to section 273(b) need not be conducted through a separate section 272 affiliate. Section 272's general separation requirement is limited by the specific provisions of section 273(b).

- "Research" activities under section 273(b)(2)(A) may include product-specific research. Any restriction to "generic" projects would both deprive section 273(b)(2)(A) of meaning and contradict Congress' goals as evidenced by the text and legislative history of the 1996 Act.

- Royalty agreements pursuant to section 273(b)(2)(B) may be volume-based and may include purchases by the Bell company itself. Any prohibition on such agreements would contradict the plain meaning of "royalty agreement" recognized by the Commission. NPRM ¶ 12. Royalty agreements should also be interpreted to permit agreements involving all intellectual property, developed independently or cooperatively, in which a Bell company has an interest. Where Congress

wished to qualify the permitted scope of such agreements in the Act, it did so expressly.

- The information disclosure obligations of section 273(c) apply only to Bell companies actually exercising manufacturing authority under section 273(a). The purpose of section 273(c) was to impose safeguards on Bell companies exercising manufacturing relief upon receipt of in-region interLATA approval under section 271. Section 273 was not designed to impose additional obligations on Bell companies irrespective of their manufacturing activities. Interpreting section 273(c) to apply additional obligations on Bell companies engaged solely in permitted activities under section 273(b) would deter beneficial cooperation. Moreover, the Bell companies must already disclose all information necessary for interconnection, and any discrimination concerns are addressed by applying section 273(c) to Bell companies actually exercising manufacturing authority.

- The Commission should exercise its forbearance authority under section 10 of the Communications Act and permit Bell companies to enter into royalty agreements involving customer premises equipment. There is no danger that such agreements could have an anticompetitive effect on the CPE market. Such agreements would further Congress' goal of enhancing competition and innovation in all equipment markets.

SBC believes that the provisions of section 273 speak for themselves. The Commission should develop only the minimum set of rules necessary to implement section 273 according to its plain terms. In these Reply Comments, SBC has at appropriate points suggested language implementing sections 273(a)-(c).

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of Section 273 of the	)	CC Docket No. 96-254
Communications Act of 1934, as amended	)	
by the Telecommunications Act of 1996	)	
	)	

REPLY COMMENTS OF SBC COMMUNICATIONS INC.

SBC Communications Inc. ("SBC"), by its attorneys and on behalf of itself and its subsidiaries, Southwestern Bell Technology Resources, Inc. and Southwestern Bell Telephone Company, files this reply to comments on the Notice of Proposed Rulemaking ("NPRM") released December 11, 1996, in the above-captioned docket.

I. THE DEFINITION OF "MANUFACTURING" IN SECTION 273

As the Commission notes, NPRM ¶ 10, section 273(h) of the 1996 Act looks to the AT&T Consent Decree, or "MFJ," for the general definition of "manufacturing" against which the specific provisions of section 273 are to be interpreted. While purporting in its opening comments to agree that the decree court's definition of "manufacturing" governs section 273, the Telecommunications Industry Association ("TIA") in fact seeks a much broader definition that is at odds with the AT&T Consent Decree and that would unreasonably hinder the Bell companies' development and operation of their networks.

The decree court defined manufacturing to include a specific group of activities relating to telecommunications equipment and CPE, including physical fabrication as well as design and development.[1] "Manufacturing" was construed by the court to encompass hardware and the "software integral to equipment hardware, also known as firmware," which is necessary for a piece of equipment to perform its intended function.[2] Development of other sorts of software is outside the decree court's definition of manufacturing.

Contrary to these congressionally incorporated interpretations, TIA suggests that "manufacturing" should include all hardware and software essential to providing a telecommunications service. Comments of the Telecommunications Industry Association ("TIA Comments") at 9 (filed Feb. 24, 1997). This expansive definition would cover network and applications software used by the Bell companies, in clear violation of the decree court's statement that producing such software is not considered "manufacturing" under the MFJ.[3] TIA attempts to support its proposed interpretation with the Act's definition of "telecommunications equipment" by claiming that this definition "encompasses hardware and software essential to the function of providing a telecommunications service." TIA Comments at 9 & n.23 (emphasis added). TIA miscites the law. In fact, the Act's definition of telecommunications equipment does not include all software needed to provide a telecommunications service; like the MFJ, it

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[1] United States v. Western Elec. Co., 675 F. Supp. 655, 662 (D.D.C. 1987), aff'd, 894 F.2d 1387 (D.C. Cir. 1990).

[2] Id. at 667 n.54.

[3] 675 F. Supp. at 667 n.54.

includes only software integral to equipment used to provide telecommunications services. 47 U.S.C. § 153(45).

TIA also asks the Commission to include in the definition of "manufacturing" any software that could perform the functions of telecommunications equipment, even if a Bell company actually uses that software for other functions. TIA Comments at 9 n.26. But the fact that software used for one purpose might simultaneously or incidentally be usable for some "functions of telecommunications equipment," id., is not sufficient to sweep the production of that software into the definition of "manufacturing." The decree court drew a "sharp distinction" between permitted network and operations software and "software integral to equipment hardware."[4] Only the latter was prohibited by the MFJ's manufacturing restriction.[5]

The decree court drew a further distinction between the engineering functions of operating local exchange networks and the "design of specific products."[6] Only the latter comes within the scope of the decree court's definition of "manufacturing." It would expand the Consent Decree's definition of manufacturing, and hence be contrary to the Act, to bar the Bell companies from producing software or algorithms used in network operations simply because they might also have product-specific applications. As Pacific Telesis has explained, it would

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[4] 675 F.Supp. at 667 n.54 (emphasis added).

[5] Id.

[6] Id. at 667-68.

similarly violate the Act to include within section 273's definition of "manufacturing" incidental or experimental development or fabrication of testing and maintenance devices.[7]

TIA also attempts to expand the scope of this proceeding to impose unwarranted restrictions on Bell companies' operational support system ("OSS") and service control point ("SCP") development. TIA Comments at 11. As TIA recognizes, it was well established under the Consent Decree that the BOCs could develop OSS and SCP software for use in their networks. Id. Because OSS and SCP software development is not "manufacturing," it falls outside the scope of section 273 and is not properly part of this proceeding. The OSS and SCP interface requirements that TIA asks for, id. at 11-12, are simply not provided for in the Act and should be rejected by the Commission.[8]

II. "COLLABORATION" UNDER SECTION 273(b)(1)

Having urged the Commission to contravene the Act and expand "manufacturing" to include design and development of network software expressly permitted by the decree court,

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[7] Comments of Pacific Telesis Group at 3-4 (filed Feb. 24, 1997) (citing United States v. Western Elec. Co., Civ. No. 82-0192, slip op. at 7-8 (D.D.C. Feb. 16, 1989)).

[8] SBC believes that the statutory language of section 273 speaks for itself. Should the Commission nonetheless decide to issue regulations implementing section 273, however, SBC proposes the following rule implementing the requirements of section 273(a):

§ 53.XXX Authorization

> Upon the Commission's grant of in-region interLATA relief for any State pursuant to 47 U.S.C. § 271(d) to a Bell operating company or its affiliate, such Bell operating company may manufacture and provide telecommunications equipment and manufacture customer premises equipment. The exercise of this authority shall be subject to the requirements of this Part. For the purposes of this section, the term "manufacturing" has the same meaning that such term had under the AT&T Consent Decree.

TIA reverses course and claims that the Act's explicit exception for "close collaboration . . . during the design and development of hardware, software, or combinations thereof related to such equipment," § 273(b)(1), does not refer to aspects of "manufacturing" at all. TIA Comments at 13. TIA contends that section 273(b)(1) instead refers only to collaboration for the limited purposes of developing "generic specifications" and cooperating to ensure "interconnection and interoperation" of products designed for use in BOC networks. Id. These activities are not manufacturing under the AT&T Consent Decree.[9]

TIA's interpretation cannot be squared with the plain language of section 273(b)(1). In stating that "[s]ubsection (a) shall not prohibit" certain activities, the text makes plain that section 273(b)(1) is carving out those activities from subsection (a)'s general rule for manufacturing by a Bell company.

Moreover, there would be no need for section 273(b)(1) if the activities to which it referred were not otherwise prohibited by section 273(a). It is a fundamental canon of statutory construction that "courts should disfavor interpretations of statutes that render language superfluous."[10] A construction of section 273(b)(1) that limited it to non-manufacturing activities not prohibited by subsection (a) would deprive section 273(b)(1) of meaning, for this section would then allow only activities that were already permitted prior to passage of the 1996 Act.

Indeed, the activities expressly permitted by section 273(b)(1), "close collaboration with any manufacturer . . . during the design and development of hardware, software, or combinations thereof related to" CPE or telecommunications equipment, fall squarely within the decree's

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[9] 675 F. Supp. at 667-668.

[10] Connecticut Nat'l Bank v. Germain, 503 U.S. 249, 253 (1992).

definition of manufacturing.[11] Under that definition, "design and development" of equipment and "of software integral to equipment hardware, also known as firmware . . . 'is a matter of manufacturing design'."[12] Those activities would thus be subject to the various rules and restrictions in section 273, but for subsection (b)(1), which expressly exempts them.

TIA's contention that subsection (b)(1) applies only to the development of "generic specifications" and "cooperative activities (e.g., product testing) which do not constitute 'manufacturing'," TIA Comments at 13, conflicts with TIA's own previous interpretation of the same statutory language. In supporting Senator Warner's unsuccessful effort to impose additional limitations on the design activities of the Bell companies, TIA President Mathew J. Flanigan stated that "the 'design' carve-out in the manufacturing section of S. 652 creates a dangerous exception to the bill's" other manufacturing restrictions.[13] Mr. Flanigan's letter further described "'design' activities" as the "most important part of the manufacturing process."[14] In an effort to gain from the FCC the barrier against competition it could not win from the Senate, TIA now implausibly argues that collaboration in those very "design" activities under section 273(b)(1) is not manufacturing at all.

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[11] Western Elec. Co., 675 F. Supp. at 668 ("Th[e] design function is an integral part of 'manufacturing,' and as such it is prohibited to the Regional Companies under section II(D)(2).").

[12] Id. at 667 n.54. As US West explains in its comments, the exemption of section 273(b)(1) applies to all aspects of product design and development, with a limitation only for actual fabrication. Comments of US West Inc. at 9 (filed Feb. 24, 1997).

[13] 141 Cong. Rec. S8310, S8362 (daily ed. June 14, 1995) (emphasis added).

[14] Id.

The legislative history of the Act confirms that Congress itself considered subsection (b) to "carve-out" certain activities that had constituted "manufacturing" under the MFJ. In floor debates on the Senate bill, Senator Dodd expressed his concern "that the legislation carves out a major exception for manufacturing research and design activities . . . one of the most expensive phases of the manufacturing process."[15] Senator Dodd noted, however, that efforts to have those exceptions dropped from the bill "proved unacceptable to the bill's managers."[16]

It is also impossible to draw from the statutory language allowing close collaboration "during the design and development of hardware, software or combinations thereof" any limitation to only "generic specifications" and "product testing," as TIA contends. Indeed, Congress enacted section 273(b)(1) against the backdrop of the decree court's opinion distinguishing development of equipment or its essential software, which constituted "manufacturing" under the decree, from development of "generic requirements," which did not.[17] It is well established that "Congress is presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it re-enacts a statute without change."[18] Where Congress expressly incorporates a specific definition -- here the definition of "manufacturing" from the AT&T Consent Decree (§ 273(h)) -- into a statute, it would be a fortiori unreasonable to suppose that Congress was unaware of the dispositive judicial

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[15] 141 Cong. Rec. S8460 (daily ed. June 15, 1995).

[16] Id.

[17] 675 F. Supp. at 666, 667-668 (describing "design of specific products " as "a far cry" from "generic specification for the network.").

[18] Lorillard v. Pons, 434 U.S. 575, 580 (1978).

explanation of that definition. Congress must be presumed to have been aware of the long-standing distinction between design and development of products like "hardware, software or combinations thereof," § 273(b)(1), on one hand, and development of "generic specifications," TIA Comments at 13, on the other.

Manufacturers strongly supported an exemption for collaborative manufacturing activities during testimony before Congress, noting that restrictions on close collaboration harmed their industry and that broad collaboration authority under the Act would provide major benefits with little risk of harm. Comments of Ad Hoc Coalition of Telecommunications Manufacturing Companies at 7-9 (filed Feb. 24, 1997). It makes no sense to claim, as TIA does, that Congress meant to resolve those problems through a statutory provision that simply allowed what had always been permitted. Nortel similarly has argued that the Commission should not stifle innovation by restricting collaborative efforts by the Bell companies and independent manufacturers. Comments of Northern Telecom Inc. at 3 (filed Feb. 24, 1997). For the Commission to restrict collaboration in the manner suggested by TIA would severely restrict the benefits of collaboration that are the very goal of subsection (b). See, e.g., BellSouth Comments at 4 (filed Feb. 24, 1997).

Interpreting section 273(b)(1) to allow Bell companies freely to engage in the permitted collaborative activities does not undermine section 272(a)(2)'s general rule that manufacturing activities are subject to the separate-affiliate requirements. See TIA Comments at 13. Section 272(a) is a general provision that, although covering manufacturing by the Bell companies, must

give way to the specific exceptions to that rule carved out in section 273(b)(1).[19] Requiring the Bell companies to undertake the permitted activities through a separate subsidiary would contradict the plain language of sections 273(b)(1) and (2). Section 272 cannot be interpreted to preclude what section 273(b) expressly allows.

Congress in fact modified the Senate bill to eliminate a provision that would have imposed structural separation requirements on the design and research activities now permitted by section 273(b). As the Senate bill was originally structured, section 256(a) contained both the basic manufacturing rule, § 256(a)(1), and a special authorization for research and design activities related to manufacturing, § 256(a)(2)(A). Section 256(b) then made "[a]ny manufacturing" under subsection (a), including research and design activities, subject to separate affiliate safeguards.[20] Conference Report at 153. The final Act, however, does not require that the excepted manufacturing activities be conducted through separate section 272 affiliates.

Moreover, requiring manufacturing activities permitted under section 273(b) to be conducted through a section 272 affiliate would lead to absurd consequences that would thwart the very intent of Congress. One of the principal purposes of section 273(b)(1) was to enable the Bell operating companies to apply their network expertise in working with manufacturers to develop advanced telecommunications products. See Ad Hoc Coalition Comments at 7-9. But section 272(c)(1), if applied to the activities permitted under section 273(b), would convert permission to collaborate into an obligation of general disclosure; the Bell operating company

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[19] "[I]t is a commonplace of statutory construction that the specific governs the general." Morales v. Trans World Airlines, Inc., 504 U.S. 374, 384-385 (1992).

[20] 141 Cong. Rec. H9954, H9967 (daily ed. Oct 12, 1995); see also S. Conf. Rep. No. 230, 104th Cong. 2d Sess. 153 ("Conference Report").

potentially could not provide information to an unaffiliated manufacturer without going through its own section 272 manufacturing affiliate and thereby triggering a nondiscrimination obligation.

III. RESEARCH ACTIVITIES AND ROYALTY AGREEMENTS

Section 273(b)(2) carves two further exceptions from the coverage of subsection (a): research activities related to manufacturing, § 273(b)(2)(A), and royalty agreements, § 273(b)(2)(B). Contrary to TIA's suggestions, the Commission should not undermine the intent of those provisions by imposing restrictions that Congress rejected.

A. Research May Be Product Specific

TIA's proposed limitation of "research activities related to manufacturing," § 273(b)(2)(A), to "generic" research is incompatible with the plain text of the 1996 Act. As explained above with respect to collaboration allowed under section 273(b)(1), subsection (b) reflects Congress' intent to allow the Bell companies to engage in specific manufacturing activities despite the general rule of section 273(a). Any interpretation limiting the research activities allowed under subsection (b)(2) to generic research, which is not "manufacturing" in the first place,[21] would deprive this grant of authority of any meaning.

Such a reading also would be inconsistent with the legislative history of section 273. Senator Warner unsuccessfully opposed the research exception on grounds that "the bill would permit the Bell operating company to undertake research . . . aspects of manufacturing."[22]

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[21] 675 F.Supp at 667-668.

[22] 141 Cong. Rec. S8310, S8361 (emphasis added).

Similarly, the House viewed research and royalty agreements to be permissible "notwithstanding subsection (a)."[23]

Contrary to TIA's assertion, TIA Comments at 15, nothing in the Commission's Non-Accounting Safeguards Order[24] supports limiting section 273(b) to "generic" research. The Commission did not attempt to define "research" or its relationship to manufacturing in the Non-Accounting Safeguards Order. The Commission merely noted that some design and development was treated as manufacturing under the AT&T Consent Decree and stated that "to the extent that research and development is part of" the manufacturing restricted by section 273(a), it is subject to section 272's general rule for Bell company manufacturing.[25] Moreover, the Commission specifically noted that it would consider the scope of permitted Bell company manufacturing activities later, in this docket.[26] The Non-Accounting Safeguards Order thus did not attempt to interpret, in advance of the Notice in this docket, the relationship of section 273(b) to the general manufacturing rule of section 273(a).

TIA's interpretation of "research" would, moreover, undermine Congress' policy goals. Consistent with those goals, the Commission in its NPRM set the important objective of implementing section 273(b)(2) in a manner that will "preserve BOC incentives to research and develop innovative products, solutions and technologies." NPRM ¶ 12. That goal is

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[23] Conference Report at 154 (emphasis added).

[24] First Report and Order, Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act, CC Dkt. No. 96-149 (rel. Dec. 24, 1996).

[25] Id. at ¶ 169 (emphasis added).

[26] Id. at ¶ 169 n. 405.

incompatible with TIA's suggestion that permissible research activities under section 273(b)(2)(A) should be restricted to "research of a 'generic'" as opposed to "product-specific" nature. TIA Comments at 15. Given the difficulty, in today's environment of rapid technological change, of discerning the line between activities that are "generic" and those that are "product-specific," any such dichotomy would deter productive research.

Bell companies will generally have the strongest incentive to undertake research to solve particular problems or achieve particular results. The goal of such research will often be a specific product -- a piece of equipment or an algorithm -- that performs the desired function. In keeping with the incentive-creating purpose recognized by the Commission, Congress imposed no artificial limitations on the research activities a Bell company may undertake pursuant to section 273(b)(2)(A).

B. Royalty Agreements May Be Volume-Based and May Include Bell Company Purchases

The Commission likewise should reject TIA's artificially constricted definition of "royalty agreements" for section 273(b)(2)(B). Section 273(b)(2)(B) without qualification permits Bell companies to enter into "royalty agreements with manufacturers of telecommunications equipment." Contrary to TIA's suggestion, there is no basis for the Commission to preclude volume-based royalty agreements or the receipt of royalties on a Bell company's own purchases of equipment. TIA Comments at 16. Not only are such limitations not provided for in subsection (b)(2)(B), but they would preclude a large number of agreements that fall centrally within the definition of "royalty agreement." As the Commission notes, NPRM ¶ 12, a principal meaning of "royalty" is compensation for use of property "expressed as a percentage of receipts"

or "as an account per unit produced."[27] To bar volume-based agreements would thus violate the plain meaning of section 273(b)(2)(B).

There are, as the Commission noted, significant pro-competitive benefits that will flow from "giv[ing] the BOCs wider latitude in structuring business transactions, and minimiz[ing] regulatory interference in the market." NPRM ¶ 12. Moreover, while the public benefits of royalty agreements are large, Ad Hoc Coalition Comments at 3, any anticompetitive concerns, NPRM ¶ 12, are remote. As discussed in numerous opening comments, Bell companies can ill afford to favor inferior products in a world where competition, especially for the most lucrative customers, is increasingly fierce, technology is developing at a rapid pace, and rate-of-return regulation has been abandoned at the federal level and in most states. See Comments of Ameritech at 16-17, Comments of U S WEST, Inc., at 15-18; Comments of SBC Communications, Inc. at 7-8. The Act, moreover, already contains numerous safeguards to prevent a Bell company from discriminating in procurement or conditioning interoperability on other carriers' purchase of equipment in which the Bell company has a royalty interest. §§ 256, 273(e).

The fact that Congress chose not to cap or otherwise circumscribe the type of permitted royalty agreements under section 273(b)(2)(B) is especially significant given the history of Bell company efforts to enter into such arrangements with manufacturers. When Congress passed the 1996 Act, the Bell companies had pending with the MFJ court a request for a waiver to enter into royalty agreements with independent manufacturers of telecommunications equipment. That

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[27] Black's Law Dictionary 1330 (6th ed. 1990).

waiver was supported by the Justice Department,[28] and traced its roots to a decision by the decree court in 1992 that such a waiver would be required for Ameritech to enter into a royalty/funding agreement with a small manufacturer.[29] In the course of that opinion, the district court discussed the potential risks and incentives that could arise under such arrangements,[30] while on appeal Judge Williams discussed both the benefits of royalty funding agreements for competition and innovation and the "marginal" anticompetitive risks they entail.[31] Congress thus enacted section 273(b)(2)(B) in the context of long debate and discussion about royalty agreements and the various terms that might be used to limit their scope. With that history before it, Congress nonetheless eschewed any limiting modifications of "royalty agreements" under section 273(b).

Where Congress did want to limit the scope of royalty agreements permitted under the Act, it did so expressly. For example, in section 274(c)(2)(C), Congress limited royalty agreements pursuant to electronic publishing joint ventures to 50 percent of gross revenues. Congress also specified in section 274 that royalty agreements would trigger the obligations and restrictions incident to ownership by a Bell company when they exceed 10 percent of the non-BOC's revenues. § 274(i)(8). No such limitations or restrictions appear in section 273(b)(2)(B),

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[28] Response of the United States in Support of the BOCs' Requests for Waivers to Receive Royalties From Certain Sales of Telecommunications Products, United States v. Western Elec. Co., No. 82-0192 (D.D.C. Mar. 22, 1995).

[29] United States v. Western Elec. Co., No. 82-0192, mem. op., (D.D.C. Jan. 31, 1992).

[30] Id. at 5-6.

[31] United States v.Western Elec. Co., 12 F.3d 225, 243-244 (D.C. Cir. 1993, Williams, J., dissenting).

which permits "royalty agreements" without limitation, in keeping with the Act's goal of encouraging innovative activity by Bell companies.

C. Royalty Agreements Should Extend to Intellectual Property Developed Cooperatively

The Commission refers in paragraph 12 of its NPRM to royalty agreements through which the BOCs license their intellectual property[32] to manufacturers. Royalty agreements permitted under the Act encompass not only patents, trade secrets and software copyrights developed by the BOCs themselves, however. The link between royalties and research incentives recognized by the Commission, NPRM ¶ 12, is just as strong where such research or development is conducted jointly with a manufacturer as when conducted by the BOC alone. Accordingly, the Bell companies should be permitted to participate in royalty agreements involving intellectual property developed in "close collaboration" with equipment manufacturers as permitted by section 273(b)(1). Such an interpretation tracks the unqualified language of section 273(b)(2)(B) and best vindicates the provision's purpose.[33]

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[32] There is no basis for restricting royalty agreements only to patents. See Joint Comments of Bell Atlantic and Nynex at 7.

[33] SBC accordingly proposes the following language implementing section 273(b)(1), should the Commission deem regulations appropriate:

§ 53.YYY Collaboration, Research and Royalty Agreements

Notwithstanding sections 53.XXX, 53.201, and 53.203 of this Part, and any other provision of these regulations, a Bell operating company or its affiliate may, without prior authorization, engage in the following activities, which may constitute manufacturing:

a) *Collaboration*. A Bell operating company or its affiliate may engage in close collaboration with any manufacturer of telecommunications or customer premises equipment, including another Bell operating company or its affiliate, during the design and development of hardware, software, or combinations thereof related to such

IV. THE INFORMATION DISCLOSURE REQUIREMENTS OF SECTION 273(c) APPLY ONLY AFTER A BELL COMPANY RECEIVES AND EXERCISES APPROVAL TO MANUFACTURE EQUIPMENT

TIA contends that the information disclosure requirements of section 273(c) apply to all Bell companies, whether or not they are engaged in manufacturing authorized under section 273(a). TIA Comments at 20. But this wrenches section 273(c) from its context. Section 273(c) is not an independent provision of the act, but a subordinate provision setting forth the "information requirements" pertaining to "Manufacturing by Bell Operating Companies," the main heading of section 273. Under section 273(a), what is "subject to the requirements of this section," including section 273(c), is the Bell companies' ability to "manufacture and provide telecommunications equipment, and manufacture customer premises equipment" pursuant to section 273(a).

> equipment. A Bell operating company shall not engage in fabrication of telecommunications or customer premises equipment pursuant to this rule.
>
> b) *Research and Royalty Agreements.*
>
> (i) A Bell operating company or its affiliate may engage in research activities related to manufacturing any telecommunications equipment or customer premises equipment.
>
> (ii) A Bell operating company or its affiliate may enter into any royalty agreement with manufacturers of telecommunications equipment or customer premises equipment. The royalty agreements authorized by this paragraph may include provisions relating to any form of intellectual property in which a Bell company or its affiliate has either sole or joint interest.

The text proposed above includes CPE in paragraph (b)(ii), reflecting SBC's view that the purposes of the Act would best be served by the Commission's forbearance from regulating royalty agreements for CPE. See Part V of these Reply Comments, infra.

It is thus the receipt and exercise of manufacturing authority under section 273(a), not the mere status of being a Bell company or mere authorization to manufacture as an incident of interLATA relief, that triggers the disclosure requirements of section 273(c). See, e.g., Comments of Ameritech at 7-8. The disclosure duty that applies generally to all incumbent LECs (and hence to all Bell operating companies) is set forth in section 251(c)(5). Applying section 273(c) outside the context of manufacturing pursuant to section 273(a) would impose additional disclosure burdens on non-manufacturing Bell companies as incidents to the status of being a "Bell company." Congress intended through section 273 to permit the Bell companies to engage in manufacturing activities subject to appropriate safeguards, not to impose additional restrictions on Bell companies irrespective of their manufacturing activities. Until a Bell company undertakes an activity that is "subject to the requirements" of section 273(a), the information disclosure requirements of section 273(c) do not apply. See generally BellSouth Comments at 11.

The Commission's concern that a lack of additional disclosure requirements will create the "potential for a BOC or BOC affiliate . . . to have a competitive advantage," NPRM ¶ 27, is implicated only where a Bell operating company engages in manufacturing pursuant to section 273(a), in which case section 273(c) clearly applies. Where the Bell company is not engaged in manufacturing, and thus has no ability to give its own manufacturing affiliate any competitive advantage, the Act permits "close collaboration" free of subsection (c)'s disclosure requirements. See, e.g., Comments of Ameritech 22-23. Concerns about network interconnection with competing carriers are dealt with under section 251, and need not be redundantly dealt with under section 273 to the detriment of the benefits for which Congress enacted subsection (b).

Requiring disclosure under subsection (c) by all Bell companies would also conflict with the purposes of section 273(b). As explained, supra, section 273(b)(1) permits close collaboration in manufacturing-related design and development between a Bell company and any equipment manufacturer, notwithstanding the general rule of section 273(a). The goal of that provision was in part to free the Bell companies from constraints on innovation and to fulfill the Act's goal of bringing the most advanced telecommunications network possible to American consumers. The Commission has recognized the link between innovation and close collaboration between Bell companies and manufacturers. NPRM ¶ 27.

Close collaboration, however, may involve exchanges, for specific and restricted purposes, of information that would not otherwise be disclosed to any manufacturer. Application of section 273(c) to non-manufacturing Bell companies creates the risk that such restricted information would, upon collaboration with one manufacturer, have to be disclosed publicly and unconditionally to all. Such a rule would force non-manufacturing Bell companies in many cases to choose between exercising their statutory rights under section 273(b) or protecting proprietary information. For that reason, the Commission should reject the contention of the Information Technology Industry Council ("ITIC") that section 273(c) should be interpreted as requiring a Bell company to disclose all "information regarding protocols and technical requirements" that it provides to "any manufacturer." ITIC Comments at 4. Nor should the Commission use its authority under section 273(c)(3) to impose similar restrictions that will interfere with the procompetitive public benefits of close collaboration.

Manufacturers seeking to develop innovative products will have little incentive to invest in collaborative arrangements if protocols developed along the way must immediately be made

available to competitors. Such a requirement creates, as the Commission recognizes, "a tension" between sections 273(b) and 273(c)(1). That tension is avoided entirely if section 273(c) is properly construed to apply only after a Bell company receives and exercises manufacturing authority under section 273(a).

It is not enough, as ITIC suggests, simply to protect information "provided to a BOC from a manufacturer." ITIC Comments at 5. Nortel has made clear that, from its point of view as a manufacturer, it "is troubled" by the prospect of rules that would require a local exchange carrier to disclose "additional, detailed information" beyond the "relevant interfaces or protocols." Comments of Northern Telecom at 6. Indeed, successful collaboration will result from information flows in both directions and there is no basis for requiring disclosure of any information by a non-manufacturing Bell company to a collaborator so long as that information does not hinder interconnection with other carriers. As Nortel has explained, the Commission should ensure that disclosure rules "do not compromise the carriers' or manufacturers' intellectual property rights." Comments of Northern Telecom at 6 (emphasis added).

ITIC's proposal that all "network" information be presumptively classified as disclosable, ITIC Comments at 5, would lead to endless attempts by parties outside the collaborative arrangement to obtain information that is simply unnecessary for legitimate interconnection purposes. This effect would only be exacerbated by ITIC's contention that "manufacturers should have an opportunity to seek additional information where they believe a BOC's initial disclosure is incomplete." ITIC Comments at 9. There is no basis for such fishing expeditions under the Act, which carefully specifies the nature of, and appropriate context for, information disclosure. The Act's prescriptions similarly foreclose any interpretation of section 273(c) that "flexibl[y]"

conditions the timing or nature of information disclosure on the "fast and furious," "unpredictable," or "disparate," demands of equipment manufacturers. ITIC Comments at 7. Such unguided and ever-changing requirements would be unadministrable for the Commission and would lead to endless uncertainty for Bell companies attempting to meet their compliance obligations.

ITIC's concern that a Bell company's technical information could give its manufacturing affiliate a competitive advantage, ITIC Comments at 6, is dealt with by applying section 273(c) in its proper context -- to Bell companies engaged in non-excepted manufacturing subject to section 273. The anticompetitive concern is weak at best when a Bell company is collaborating with an independent equipment maker. And Congress, in section 273(b), has already made the judgment that the benefits of such collaboration outweigh the remote potential for anticompetitive harm. The Commission should not countermand that judgment through imposition of additional disclosure requirements that will hinder close collaboration between manufacturers and Bell companies. ITIC's textually unsupported call for rules that require all "BOCs to disclose all technical data and protocols necessary for manufacturers to design and build a competitive product," ITIC Comments at 7, would have precisely that effect.[34]

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[34] SBC proposes the following rule to clarify the application of section 273(c), should the Commission deem implementing regulations appropriate:

§ 53.ZZZ Information Disclosure

a) The requirements of this Section shall apply to any Bell company or affiliate thereof engaged in manufacturing pursuant to section 53.XXX of this Part. Nothing in this Section shall be construed to apply by reason of manufacturing activities authorized under section 53.YYY of this Part.